

## Message Text

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### 1. INTRODUCTION

FOR MOST OF ITS POSTWAR CAREER, HONG KONG HAS BEEN A RAPIDLY DEVELOPING LDC WITH A HIGH DEMAND FOR INVESTMENT FUNDS. IT HAS BEEN A NET CAPITAL IMPORTER WITH INFLOWS FROM THE U.K., WESTERN EUROPE AND JAPAN AND FROM OVERSEAS CHINESE IN THE EAST ASIAN REGION. UNTIL THE BEGINNING OF THE SEVENTIES, ITS BANKS REFLECTED THAT ORIENTATION, I.E., THEIR CUSTOMERS WERE PRIMARILY LOCAL.

### 2. SUMMARY: THE PRINCIPAL CONCLUSIONS ARE:

- A) THERE IS NO GOVERNMENT CONTROL OVER FOREIGN LENDING;
  - B) FOREIGN BANKS, MAINLY U.S. AND JAPANESE, RELYING ON HEAD-OFFICE GUIDELINES, ACT AS REGIONAL WHOLESALE DISTRIBUTORS OF EURO/ASIAN DOLLARS,
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C) THE ONE INTERNATIONAL BANK WITH HEADQUARTERS IN HONG KONG

HAS BEEN INCREASING ITS REGIONAL LENDING MORE SLOWLY SINCE THE END OF 1973;

D) IT EXPECTS TO FOLLOW A SIMILAR POLICY IN 1975 BASED ON THE EXPECTATION THAT THE U.S. ECONOMY WILL NOT TURN UP UNTIL THE END OF 1975 AND,

E) IT USED INDIVIDUAL COUNTRY LIMITS BASED ON ITS CONTROL OVER LOCAL RESOURCES AND ITS ASSESSMENT OF COUNTRY POLITICAL STABILITY AND ABILITY TO SERVICE DEBT.

3. THE HKG HAS NO POLICY WITH RESPECT TO OFFSHORE BANK LENDING. EXCHANGE CONTROLS WERE ABOLISHED AT THE END OF 1973 AND NO INFORMAL INFLUENCE IS EXERCISED. BUT THE ABSENCE OF A CENTRAL BANK AND A TREASURY BILL MARKET, IN COMBINATION WITH THE BANKING ORDINANCE WHICH PROVIDES FOR A 25 PERCENT LIQUIDITY REQUIREMENT FOR DEPOSITS, FORCES THE LICENSED COMMERCIAL BANKS ("MERCHANT BANKS" ARE FOR THE MOMENT NEITHER LICENSED OR REGULATED) TO PLACE SUBSTANTIAL ASSETS IN GOVERNMENT SECURITIES IN LONDON OR NEW YORK AS DEPOSITS RISE.

4. IN THE LAST THREE YEARS, MANY FOREIGN BANKS, PRIMARILY U.S. AND JAPANESE, HAVE ESTABLISHED "MERCHANT BANKS" OR BOUGHT INTO EXISTING LOCAL COMMERCIAL BANKS, ATTRACTED BY THE HIGH RATE OF GROWTH IN THE ASIA-PACIFIC REGION, A LOW TAX RATE AND A GOVERNMENT POLICY WHICH CLEARLY ENCOURAGED THEM TO ESTABLISH THEMSELVES IN HONG KONG.

5. THESE INSTITUTIONS ARE VERY MUCH INTERESTED IN INTERNATIONAL LENDING IN THE REGION AND THEY HAVE BECOME INCREASINGLY ACTIVE. HOWEVER, SOME OF THIS FOREIGN LENDING IS REALLY TO THE OFFSHORE AFFILIATES OF HONG KONG BASED COMPANIES, PARTICULAR FOR THE FINANCE OF SHIPS. BUT THESE FINANCIAL INSTITUTIONS HAVE A MINIMAL CAPITALIZATION AND A VERY LOW LOCAL DEPOSIT BASE AND THEREFORE, DEPEND ESSENTIALLY ON THE REPUTATION AND RESOURCES OF THEIR HEAD OFFICES TO BORROW FUNDS FROM THE EURO/ASIAN DOLLAR MARKET. THESE LOANS ARE LARGELY IN U.S. DOLLARS BOTH BECAUSE THE HONG KONG DOLLAR IS NOT WIDELY USED AND THERE IS NO SIGNIFICANT CAPITAL GOODS INDUSTRY. ESSENTIALLY, THESE FOREIGN BANKS ARE REGIONAL WHOLESALE DISTRIBUTORS CARRYING OUT POLICIES DRAWN UP IN NEW YORK, SAN FRANCISCO AND TOKYO.

6. THE ONE LARGE INSTITUTION WHOSE POLICY IS MADE IN AND RESOURCES LIMITED OFFICIAL USE

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DRAWN MAINLY FROM HONG KONG IS THE HONG KONG AND SHANGHAI BANK. IT CONTROLS APPROXIMATELY 60 PERCENT OF HONG KONG DOLLAR BANK DEPOSITS. THE GROUP HAD ASSETS OF APPROXIMATELY US\$10 BILLION AT THE END OF 1974 WITH BRANCHES OR AFFILIATES THROUGHOUT SOUTH-EAST ASIA, INDIA, THE MIDDLE EAST, WESTERN EUROPE AND THE U.S. WITHIN HONG KONG, IT FUNCTIONS AS A SEMI-OFFICIAL CENTRAL BANK E.G., IT ISSUES MOST OF THE CURRENCY, SERVES AS GOVERNMENT FISCAL AGENT AND AS A LENDER OF LAST RESORT ON OCCASION.

7. PARTLY BECAUSE OF ITS CENTRAL BANKING FUNCTIONS AND PARTLY BECAUSE ITS MANAGEMENT ARE THE SORT OF "PRUDENT" BANKERS THAT HAVE GONE OUT OF FASHION IN MORE SOPHISTICATED PLACES, THE BANK USES A GUIDELINE OF 30-35 LIQUIDITY INCLUDING CAPITAL. THIS WOULD BE CASH AND INVESTMENTS WITH MATURITIES OF ONE MONTH OR LESS. IT HAS FOLLOWED A POLICY OF RESTRICTING CREDIT INCREASE SINCE LATE 1973 FOR ALL BRANCHES BECAUSE OF FEARS OF THE DETERIORATING WORLD SITUATION. IT EXPECTS TO MAINTAIN THIS STANCE IN 1975 BASED ON ITS ASSESSMENT THAT THE U.S. WILL NOT RECOVER FROM ITS RECESSION UNTIL THE END OF 1975, DELAYING FAVORABLE EFFECTS ON THE EAST ASIAN REGION UNTIL THE SPRING OF 1976.

8. INDIVIDUAL COUNTRY EXPOSURE LIMITS ARE USED. THESE ARE BASED ON RESOURCES AVAILABLE IN LOCAL BRANCHES AND OTHER AFFILIATES AND LOCAL BORROWING PLUS A SMALL SUPPLEMENT FROM THE ASIAN DOLLAR MARKET. THE MAIN VARIABLE ELEMENT IS RECOURSE TO THE ASIAN DOLLAR MARKET. IT DEPENDS HEAVILY ON THE BANK'S ASSESSMENT OF POLITICAL STABILITY, AND THE COUNTRY'S CAPACITY TO SERVICE EXTERNAL BORROWING, WHICH, IN TURN, IS RELATED BOTH TO THE EXPORT OUTLOOK AND THE OUTSTANDING VOLUME OF DEBT. THE LIMITS ARE BASED ON MATURITIES UP TO FIVE YEARS. IT DOES NOT NORMALLY LEND FOR LONGER PERIODS. BASED ON MONTHLY REPORTS FROM LOCAL MANAGERS AND TRIPS FROM THE HEAD OFFICE, THESE LIMITS ARE FLEXIBLE ONLY TO THE EXTENT THAT THERE IS A REASSESSMENT OF THE MAJOR FACTORS LISTED. FOR EXAMPLE, A LARGE DROP OR RISE IN COMMODITY PRICES WOULD EFFECT THE EXPOSURE LIMIT. PAYMENT OF HIGHER INTEREST RATES DOES NOT APPEAR TO BE A CONSIDERATION. THE BANK LENDS INDIRECTLY, OUTSIDE THESE EXPOSURE LIMITS, BY CREDITS TO THE MANY HONG KONG BASED COMPANIES THAT UNDERTAKE INVESTMENTS IN SOUTHEAST ASIA. BUT THESE LOANS ARE SECURED LOCALLY AND ARE SIMILAR TO OTHER HONG KONG DOLLAR CREDITS.

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9. IT CHARACTERIZES ITS USE OF ASIAN DOLLARS AS RELATIVELY SMALL COMPARED TO OTHER RESOURCES BECAUSE OF THE HIGH CONCENTRATION OF SHORT-TERM DEPOSITS IN THAT MARKET. THE GROUP AS A HOLE TENDS TO BE A NET LENDER TO THE ASIAN DOLLAR MARKET.

10. THE BANK IS NOT OVERLY IMPRESSED BY GOVERNMENT OR INTERNATIONAL SUPPORT AND TENDS TO BASE ITS LENDING ON ITS OWN JUDGEMENT AND WILLINGNESS TO BEAR RISKS.

11. WITH REGARD TO INDIVIDUAL COUNTRIES, THE BANK'S ASSESSMENT IS THAT KOREA HAS PROBABLY OVER BORROWED (THIS IS SOMEWHAT THEORETICAL SINCE IT DOES NOT HAVE A BRANCH THERE), AND THE PHILIPPINES HAS PROBABLY REACHED THE LIMIT OF ITS EXTERNAL BORROWING. MALAYSIA IS HAVING SERIOUS DIFFICULTIES BUT IT SHOULD BE HELPED BY ARAB MONEY, WHICH, IN FACT, THE BANK IS HELPING TO

ARRANGE.

12. THE 1974 BALANCE SHEET WILL NOT BE OUT FOR ANOTHER MONTH.  
ALTHOUGH IT DISCLOSES VERY LITTLE AND PROVIDES NO BREAKDOWN  
BETWEEN LOCAL AND OVERSEAS LENDING,IT WILL BE ANALYZED TO THE  
EXTENT POSSIBLE WHEN RECEIVED.  
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